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# U.K. Raises Bank-Stake Issue for an Averse U.S.

Cultural, structural differences drive asset buys here

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WASHINGTON — The United States and the United Kingdom — two countries, similar problems, different solutions.

While the British are moving to invest capital directly into their largest banks, U.S. government officials are taking a broader approach in buying shaky assets from a variety of firms.

The choices highlight cultural and structural differences between the two nations.

Observers said the U.S. is reluctant — at least so far — to take the same path due to differing views of the underlying cause of the crisis and the fact that its financial system is much larger. But the most powerful factor may be cultural — the U.S. is simply adverse to government ownership of private enterprises.

"The Brits are quicker to own equity in a private company than we have been," said Mark Flannery, a finance professor at the University of Florida. "The Brits are more used to nationalizing things."

The U.K. has already nationalized two mortgage lenders — Northern Rock and Bradford & Bingley. Nationalizing a bank in the U.S. "conflicts with our basic philosophy with how we want to manage our economy," said George Kaufman, co-chair of the Shadow Financial Regulatory Committee and a professor at Loyola University. "It's going all the way to socialism. Once it becomes publicly owned it becomes difficult to be privately owned."

There are signs that resistance is easing, however. The government seized Fannie Mae and Freddie Mac on Sept. 7 and agreed to invest $80 billion in American International Group. The Federal Deposit Insurance Corp. was poised to take a $12 billion equity stake in Citigroup Inc. before its deal for most of Wachovia Corp. was derailed.

Some lawmakers on Wednesday began calling for the U.S. to consider following the U.K.'s lead.

"Many experts agree that re-capitalizing U.S. banks directly would be an effective and less costly way to address the frozen credit markets," said Sen. Charles Schumer, the chairman of the Joint Economic Committee, in a press release. "London may now provide a key test case for a proposal that has a lot of promise."

There is also historical precedent for such a move.

Lasse Pedersen, a professor of finance at New York University, pointed to the Reconstruction Finance Corp. created during the Great Depression as an instance where the government bought preferred stock in banks. Banks were initially reluctant to participate, but ultimately the program purchased $782 million of bank preferred stock in 4,202 banks.

"The U.S., in the AIG deal for instance, the government also has equity participation, and I believe that going forward when the U.S. is going to lend they will also be able to have equity participation," he said.

Still, when Treasury Secretary Henry Paulson developed a rescue plan to buy troubled assets equity investment was not on the table. Treasury eventually — and reluctantly — agreed it would consider taking stakes in companies selling assets to the buyout facility created by a Sept. 3 law.

Scott Talbott a senior vice president with the Financial Services Roundtable, said the notion of the government more broadly investing directly in financial institutions was considered during debate on the bailout bill, but was rejected because policymakers were afraid of where it could lead.

"The problem with direct purchase of shares by the government is you create conflicts of interest," he said. "Suppose a bill comes up on the floor that would benefit the industry or the government; or that company it has an ownership stake in. It has to take into account the government's interest as an owner and the taxpayers' and those interests may be at odds."

Mr. Talbot said such a shift in approach would be a "sea change."

"It would cross the Rubicon... At that point you are moving into socialization," he said.

A top adviser to Sen. John McCain, the Republican presidential candidate, also raised concerns about such a move. "That was never raised" during discussion of the bailout bill, said Douglas Holtz-Eakin, a former director of the Congressional Budget Office, in an interview. "Regardless of its economic merits, if the administration were to go to direct capital injections and public ownership of private institutions — without the seal of approval from Congress — that would be shocking."

The difference between the U.S. and U.K. approaches also reflects how the two countries define the underlying cause of the housing crisis. Mr. Paulson's plan is focused on ensuring liquidity at banks by allowing them to sell bad assets; the U.K.'s plan is focused on bolstering capital.

"The issue in part goes to the diagnosis of the problem and the speed with which one can rectify it," said Raghuram Rajan, a professor of economics at the University of Chicago.

William Isaac, a former chairman of the Federal Deposit Insurance Corp., said the United Kingdom is tackling the right problem but the United States is not.

"We haven't attacked the capital problem," he said. "We are just throwing all kinds of liquidity at the system, and the system doesn't need liquidity, and that's why I think the Treasury plan won't solve the problem."

Both the U.S. and U.K. plans focus on the overarching theme of restoring confidence in the financial markets, however.

"It's a combination of liquidity and solvency," said Mr. Rajan. "The bank may shut down on me, and I'm left holding the bag. How do you rectify this? You have to reinstill confidence."

Even if Treasury decided to follow the U.K.'s lead, implementing such a program would be vastly more costly here. The British government agreed to invest $86 billion in its eight largest banks. The banking systems in general are hardly comparable. The British have 163 depository institutions — the United States, 8,451.

"In the U.S. the banking system is a lot bigger, and there may be political opposition to the government playing a similar role," said James Sweeney, a vice president of fixed-income global strategy research at Credit Suisse.

John Douglas, an attorney at Paul, Hastings, Janofsky & Walker LLP and former FDIC general counsel, noted the U.K. has "very few banks…In a sense they are all systemically important."

Observers also argued that the British banks are less well capitalized than U.S. ones, making capital injections more necessary.

"In general, it's something that U.S. banks need less," said William Porter, managing director of credit strategy in Europe for Credit Suisse. "They've been probably more successful at raising capital than U.K. banks."

Ed Yingling, the president and chief executive of the American Bankers Association, defended the capital positions of U.S. banks and brushed off the British solution as unnecessary here. "I would see no reason for there to be that type of approach in the United States," he said. "We have over $1.3 trillion in capital; the great, great majority of banks are well capitalized."

Despite the differences in approach, some observers would not rule out the United States' investing directly in banks if the asset-buying facility fails to gain traction. "We have the capacity to do more if it's necessary," Mr. Douglas said.

*Stacy Kaper and Emily Flitter contributed to this story.*